

The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. 86 Ill. Adm. Code 140.141. (This is a GIL.)

July 17, 2003

Dear Xxxxx:

This letter is in response to your letter dated March 3, 2003. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at [www.revenue.state.il.us/Laws/regs/part1200/](http://www.revenue.state.il.us/Laws/regs/part1200/).

In your letter, you have stated and made inquiry as follows:

This is to request a ruling of the Illinois Department of Revenue with respect to the application of Illinois' Retailer's Occupation Tax and Use Tax to a new product that will potentially be offered by one of our clients.

## **FACTS**

Our client is a retailer of consumer electronics and offers extended warranty coverage on many of its product for an additional charge. The traditional method of selling extended warranty coverage has been for a sales associate to query the customer at the time of the sale and to add the additional coverage to the sales invoice, with the retailer providing the related paperwork (the warranty agreement itself, instructions on making warranty claims, etc.) to the customer in an envelope, folder, or sleeve.

Our client is considering variations on this traditional theme for the marketing and delivery of warranty agreements and these potential changes are the reason for this ruling request. Specifically, our client is considering allowing customers to purchase warranty plans off-the-shelf without prompting by a sales association. The concept is referred to within the company as a 'warranty in a box,' with the idea being that warranty products would be prominently displayed on store shelves in close proximity to products such as televisions, home computers, digital cameras, etc., where consumers frequently desire additional product protection. Our client plans to market these types of warranties only for consumer electronics products; it will not market warranties for software products sold in its retail stores.

The 'box' would contain the same types of paperwork that a consumer purchasing a warranty plan today would normally receive (the warranty agreement itself, instructions

on making warranty claims, etc.). As such, we see only three differences between our client's current warranty product and the new 'warranty in a box':

- The warranty-related paperwork would be packaged in a more secure fashion; for example, on warranties for big-ticket products, our client is considering packaging the documents in a small ring binder which would be more difficult for the customer to misplace once he takes the warranty home.
- The warranty is designed and packaged in such a way that the consumer can take the product off-the-shelf and proceed directly to the store cashier for coverage activation without having to go through the longer, more cumbersome process of signing up for the agreement with a sales representative.
- The warranty in a box may also include free promotional samples of other products (for example, the maintenance agreement on a home computer might include a free CD containing maintenance utilities software); manufacturer or retailer coupons for other products; and/or rebate offers for other products. No additional charge will be made for these items as they are purely promotional in nature.

## **RULING REQUESTED**

Our client wishes to confirm that the changes in the way it markets and packages its extended warranties will not affect the current Retailer's Occupation Tax treatment of the product in Illinois, i.e., that off-the-shelf sales of optional extended warranties will continue to be considered non-taxable. Additionally, we wish to clarify whether use tax must be accrued on the cost price of packaging that is shipped to our client's Illinois stores for ultimate sale or whether the packaging might qualify for a resale exemption.

## **DISCUSSION**

Illinois' treatment of extended warranties is set forth in 86 Ill. Adm. Code 140.141(c)(2):

Extended warranties are contracts to provide repairs for a particular item for a stated period of time after a manufacturer's express warranty has expired. An extended warranty is not included in the selling price of the item covered by the warranty and, for that reason, the selling price of the extended warranty is not subject to Retailer's Occupation Tax and Use Tax Liability when the item is sold at retail. Consequently repairs made under a maintenance agreement result in tax liability. (See 86 Ill. Adm. Code 140.301(b)(3); 35 ILCS 105/3-75 and 35 ILCS 120/2-55.)

Pursuant to this provision, our client does not need to collect tax when it sells an extended warranty, but is responsible for paying Illinois Use Tax on the parts and materials it uses to repair its customers products pursuant to an extended warranty agreement. The extended warranty products that our client sells have always been optional to the purchaser and this will not change with the new 'warranty in a box.' The only thing that will change is the manner of presentation of the warranty agreement and related documentation, which would be combined with various promotional items and packaged in a box or binder.

As such, the object of the transaction should still be the acquisition of the non-taxable warranty agreement and the services available under that agreement. The 'new' packaging of the agreement in a box or binder would simply be incidental to the services available under the agreement, just as the contract document and related paperwork are considered incidental tangible personal property to the agreements sold under our client's current marketing strategy. The new marketing/packaging strategy can be likened to an attorney changing his procedures to provide a will or other legal document to a client in a binder, rather than an envelope -- the true object of the transaction is still the professional expertise of the attorney, rather than the tangible medium in which he transmits his work product. When viewed in these terms, we believe that our client's 'warranty in a box' product should remain non-taxable in Illinois.

The applicability of Illinois use tax to the packaging components of warranty contracts does not appear to have been addressed before by the Department of Revenue. 86 Ill. Adm. Code 140.301(b)(3) requires payment of use tax on repair parts transferred to customers pursuant to a non-taxable warranty agreement. The question posed here, though, is whether the Department of Revenue will require payment of use tax on packaging materials used to deliver the warranty agreement itself or whether a resale exemption will be available.

86 Ill. Adm. Code 130.2070(b)(1) provides an exemption on the sale of containers to purchasers who transfer the ownership of the containers to their customers together with the ownership of the tangible personal property contained in such containers. Nothing in the provision appears to prevent enjoyment of the exemption in instances where the tangible personal property contained in the container is itself exempt from tax. Our client will purchase empty packaging materials, insert the warranty agreement and related documents, and then sell the agreement off-the-shelf, seemingly meeting the requirements for the exemption. However, we recognize that this may not be a settled issue under Illinois law and we appreciate your guidance. This guidance will enable our client to accrue use tax in Illinois, if necessary.

We appreciate you providing guidance on these issues. If you have any questions, please do not hesitate to call me. Thank you for your assistance.

The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed. 86 Ill. Adm. Code 140.141.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Since the item your client is transferring is not tangible personal property, the provisions of Section 130.2070 do not apply. Your client will incur a Use Tax liability on the packaging materials that are given to the customer along with the sale of the intangible warranty agreement.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk  
Enc.